

Report
of the
Examination of
Moraine Mutual Insurance Company
Jackson, Wisconsin
As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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May 10, 2002

Honorable Connie L. O'Connell
Commissioner of Insurance
State of Wisconsin
121 East Wilson Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of
December 31, 2001, of the affairs and financial condition of

MORAINE MUTUAL INSURANCE COMPANY

Jackson, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1997 as of December 31, 1996.
The current examination covered the intervening time period ending December 31, 2001, and
included a review of such subsequent transactions deemed essential to complete this
examination.

The Summary of Examination Results contains elaboration on all areas of the
company's operations. Special attention was given to the action taken by the company to satisfy
the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on
January 6, 1880, under the provisions of the then existing Wisconsin Statutes. The original name
of the company was the West Bend, Polk and Richfield Farmers' Mutual Insurance Company.

Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there was an amendment to the articles of incorporation and an amendment to the bylaws. The company changed article III of the articles of incorporation, which now states that there will be five members on the board of directors. The company changed sub-section 1 of the bylaws, which now states that no person shall be eligible to be a director once they have obtained the age of 70.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

Dodge, Jefferson, Fond du Lac, Ozaukee, Sheboygan,
Washington, Waukesha, and Walworth

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of one year with premiums payable on the advance premium basis. Policy fees charged policyholders are retained by the company.

Business of the company is acquired through 33 agencies having approximately 177 agents, 3 of whom are directors of the company. Agencies are presently compensated for their services as follows:

Type of Policy	Compensation
Commercial	13%
Dwelling	18
Farm Fire	13
Farmowner	18
Homeowner	20
Preferred Homeowner	18
Tenant Homeowner	18
Mobile Homeowner	20
Condominium	18
Hobby Farmowner	18
Preferred Hobby Farmowner	18

In addition, any agency that produces at least \$20,000 in gross premiums written, with timely remittance of amounts due, is eligible to participate in the profits earned by the company

from its production. Qualifying agencies are paid a contingent commission equal to 5% of the company's profits as determined by a formula calculation set forth in the contingency commission contract. If the current year's growth in gross premiums written by the agency is at least 10% over the previous calendar year, a bonus of an additional 2% of formula calculation profits are paid.

Losses are adjusted by Secretary/treasurer. Agents are allowed to adjust small losses at the discretion of the company.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors currently consists of five members divided into three classes as equal as possible. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Sue Monday	Secretary/Treasurer-Moraine	West Bend	2003
Thomas Bartelt	Insurance Agent	West Bend	2003
Gerald Kiefer	Attorney	Sheboygan Falls	2004
Ron Bretl	Insurance Agent	Menomonee Falls	2004
Paul Albinger	Insurance Agent	West Bend	2002

Paul Albinger sold his agency at the beginning of 2002.

Members of the board currently receive \$150.00 for each meeting attended and \$0.365 per mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	Annual Salary
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Paul Albinger	President	\$ 4,800
Thomas Bartelt	Vice President	2,000
Sue Monday	Secretary/Treasurer	40,732

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Claims Committee

Tom Bartelt
Gerald Kiefer
Ron Bretl

Rate Committee

Tom Bartelt
Gerald Kiefer
Ron Bretl

Investment Committee

Tom Bartelt
Gerald Kiefer
Ron Bretl

Paul Albinger as President has the option to attend all standing committee meetings, while Sue Monday, secretary/treasurer, is considered a member at large of all committees.

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1997	\$757,140	\$299,001	2,165	\$128,954	\$2,183,122	\$1,451,697
1998	764,646	636,080	2,067	(171,255)	2,081,406	1,374,039
1999	736,628	280,445	1,961	148,203	2,182,591	1,514,633
2000	696,798	432,391	1,919	(9,010)	2,295,086	1,586,207
2001	691,377	584,842	1,966	(181,143)	2,341,984	1,367,182

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
1997	\$ 1,103,355	\$809,236	\$ 1,451,697	76%	56%
1998	1,107,737	753,956	1,374,039	81	55
1999	1,129,237	755,241	1,514,633	75	50
2000	1,134,033	700,810	1,586,207	72	44
2001	1,206,214	728,734	1,367,182	87	53

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Premiums Earned	Loss Ratio	Expense Ratio	Composite Ratio
1997	\$299,001	\$392,629	\$757,140	39%	49%	88%
1998	636,080	377,415	764,646	83	50	133
1999	280,445	379,218	736,628	38	50	88
2000	432,391	348,007	696,798	62	50	112
2001	584,842	359,621	691,377	85	49	134

Although policies in force have been declining, gross premiums written continue to rise due to larger coverages on new business as well as existing policyholders increasing coverage. The underwriting expense ratio remained consistent over the past five years, but high for a company of its size. This is due to the fact that the company has higher than average commissions. The company feels that the higher commissions lead to having better agents, better loss ratios, and ultimately a stronger financial position for policyholders. Due to hail and

windstorms over the past few years, the company has had negative net income in three of the past five years.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2002, continuous
Termination provisions:	January 1, 2003, or any subsequent January 1, by either party providing at least 90 days' advance notice in writing

The coverages provided under this treaty are summarized as follows:

- | | |
|----------------------|---|
| Type of contract: | Excess of Loss (Class A) |
| Lines reinsured: | Nonproperty |
| Company's retention: | \$1,500 per occurrence, annual aggregate not to exceed the lesser of \$200,000 or 20% of prior year's surplus |
| Coverage: | 100% in excess of \$1,500 for each and every loss occurrence. Single limit of \$1,000,000 per occurrence |
| Reinsurance premium: | 75% of liability premium |
| Ceding commission: | None |
- | | |
|----------------------|--|
| Type of contract: | First Surplus (Class B) |
| Lines reinsured: | All property business written |
| Company's retention: | \$500,000 |
| Coverage: | Pro rata share of each and every loss including LAE. When the company's net retention is \$500,000 or more, the company may cede on a pro rata basis up to \$800,000. When net retention is less than \$500,000, the company may cede up to 50% of such risk |
| Reinsurance premium: | The pro rata portion of premiums corresponding to the amount of each risk ceded |
| Ceding commission: | 15.0% sliding scale
Minimum=15%, maximum=35% |

3. Type of contract: Excess of Loss First Layer (Class C-1)
Lines reinsured: All property business written
Company's retention: \$30,000 per loss with an annual aggregate deductible of \$25,000
Coverage: 100% of any loss in excess of the retention up to \$70,000, excluding LAE
Reinsurance premium: Net premiums written X [sum of the prior four years' losses incurred divided by the total net premium written for the same period multiplied by a factor of 100/80ths]
Minimum rate: 6.00% of NPW
Maximum rate: 22.00% of NPW
The rate for the current annual period is 10.54%
Ceding commission: None
4. Type of contract: Excess of Loss Second Layer (Class C-2)
Lines reinsured: All property business written
Company's retention: \$100,000 in respect to each and every risk resulting from one loss occurrence
Coverage: 100% of each loss occurrence, excluding LAE, in excess of \$100,000 subject to a maximum of \$200,000
Reinsurance premium: 2.00% of the company's net premium subject to a minimum of \$14,400
Ceding commission: None
5. Type of contract: Excess of Loss Third Layer (Class C-3)
Lines reinsured: All property business written
Company's retention: \$300,000 in respect to each and every risk resulting from one loss occurrence
Coverage: 100% of each loss occurrence, excluding LAE, in excess of \$300,000 subject to a maximum of \$200,000
Reinsurance premium: 1.00% of the company's net premium subject to a minimum of \$7,200
Ceding commission: None

6. Type of contract:	Stop Loss (Class D/E)
Lines reinsured:	All business written
Company's retention:	Aggregate losses, excluding LAE, up to 70% of net premium written subject to a minimum net retention of \$535,000
Coverage:	100% of the amount by which the aggregate of the company's losses (excluding LAE) exceeds the retention
Reinsurance premium:	<p>Net premiums written X [sum of the prior eight years' losses incurred by reinsurer, divided by the total of net premiums written for the same period multiplied by a factor of 100/80ths]</p> <p>Minimum rate: 6.00% of NPW</p> <p>Maximum rate: 25.00% of NPW</p> <p>The rate for the current annual period is 10.09%</p>
Ceding commission:	None

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2001. Adjustments made as a result of the examination are noted in the section of this report captioned "Reconciliation of Policyholders' Surplus."

Moraine Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2001

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash Deposited in Checking Account	\$ 5,213	\$	\$	\$ 5,213
Cash Deposited at Interest	701,783			701,783
Bonds (at Amortized Cost)	640,162			640,162
Stocks or Mutual Fund Investments (at Market)	622,469			622,469
Real Estate (Net of Accumulated Depreciation and Encumbrances)	7,885			7,885
Premiums and Agents' Balances in Course of Collection	8,996		469	8,527
Premiums and Agents' Balances and Installments Booked But Deferred and Not Yet Due	144,630			144,630
Investment Income Due or Accrued		15,454		15,454
Reinsurance Recoverable On Paid Losses and LAE	180,000			180,000
Electronic Data Processing Equipment - Excluding Software (Cost Less Accumulated Depreciation	6,282			6,282
Other Assets				
Federal Income Tax Receivable	9,579			9,579
Prepaid expenses		9,054	9,054	
Automobile				
Furniture and Fixtures	<u>3,403</u>	<u></u>	<u>3,403</u>	<u></u>
TOTALS	<u>\$2,330,402</u>	<u>\$24,508</u>	<u>\$12,926</u>	<u>\$2,341,984</u>

Liabilities and Surplus

Net Unpaid Losses	\$ 234,790
Unpaid Loss Adjustment Expenses	585
Commissions Payable	62,261
Fire Department Dues Payable	541
Net Unearned Premiums	579,740
Reinsurance Payable	88,695
Payroll Taxes Payable	42
Other Liabilities:	
Accounts Payable	<u>8,148</u>
TOTAL LIABILITIES	974,802
Policyholders' Surplus	<u>1,367,182</u>
TOTAL	<u>\$2,341,984</u>

Moraine Mutual Insurance Company
Statement of Operations
For the Year 2001

Net Premiums and Assessments Earned	<u>\$691,377</u>
Deduct:	
Net Losses Incurred	543,752
Net Loss Adjustment Expenses Incurred	41,090
Other Underwriting Expenses Incurred	<u>359,621</u>
Total Losses and Expenses Incurred	<u>944,463</u>
Net Underwriting Gain (Loss)	<u>(253,086)</u>
Net Investment Income:	
Net Investment Income Earned	71,353
Net Realized Capital Gains	<u>0</u>
Total Investment Income	<u>71,353</u>
Other Income:	
Miscellaneous Income	<u>590</u>
Net Investment and Other Income	<u>71,943</u>
Net Income Before Policyholder Dividends and Before Federal Income Taxes	(181,143)
Policyholder Refunds or Dividends	<u>0</u>
Net Income Before Federal Income Taxes	(181,143)
Federal Income Taxes Incurred	<u>0</u>
Net Income	<u><u>\$(181,143)</u></u>

Moraine Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2001

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	1997	1998	1999	2000	2001
Surplus, beginning of year	\$1,326,850	\$1,451,697	\$1,374,039	\$1,514,633	\$1,586,207
Net income	128,954	(171,255)	148,203	(9,010)	(181,143)
Net unrealized capital gains or (losses)	1,461	98,701	(9,872)	66,904	(39,196)
Change in non-admitted assets	(5,568)	(5,104)	2,263	13,680	1,314
Surplus, end of year	<u>\$1,451,697</u>	<u>\$1,374,039</u>	<u>\$1,514,633</u>	<u>\$1,586,207</u>	<u>\$1,367,182</u>

Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' Surplus per December 31, 2001, Annual Statement	\$1,367,182
Item	Increase
Unpaid Losses	<u>\$125,900</u>
Increase to Surplus per Examination	<u>125,900</u>
Policyholders' Surplus per December 31, 2001, Examination	<u>\$1,493,082</u>

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is recommended that the company maintain a single list of outstanding agent appointments organized by agency.

Action—Compliance

2. Conflict of Interest—It is recommended that conflict of interest statements be completed on an annual basis as required by the directives of the Commissioner of Insurance.

Action—Compliance

3. Accounts and Records—It is recommended that the company maintain a policy register or other similar report which lists risk in force, risk in force reinsured, and reinsurance premium, in accordance with s. Ins 13.05 (3) (a), Wis. Adm. Code.

Action—Compliance

4. Invested Assets—It is recommended that all safekeeping agreements obligate custodians to promptly indemnify the company for losses caused by custodial negligence or dishonesty and to maintain the company's securities in such a manner that they may at all times be identified as belonging solely to the company.

Action—Compliance

5. Bonds—It is recommended that the company arrange to have its custodians send periodic custodial statements summarizing principal and income transactions on its account, no less frequently than at the end of each calendar quarter.

Action—Compliance

6. Net Unpaid Losses—It is recommended that the company adopt procedures for timely settlement of claims, in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

Action—Compliance

7. Accounts Payable—It is recommended that the company reconcile errors detected by the payroll clearing account on a timely basis.

Action—Compliance

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent current period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

The company's conflict of interest policy does not determine that a director who is also an agent for the company has a potential conflict of interest. There are some issues the board may consider where a director who is an agent should abstain from voting, pursuant to ss. 612.18 and 611.60, Wis. Stat.; examples include but are not limited to: changing commission rates, establishing standards for agent production volume or loss ratio, and establishing standards for termination of agents. It is recommended that the company amend its conflict of interest policy to require that directors who are agents for the company must disclose this fact as a potential conflict of interest, and that directors with a potential conflict should not vote on matters related to the potential conflict, pursuant to s. 612.18, Wis. Stat.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity Bond	\$ 125,000
Professional Liability and Directors and Officers Liability	5,000,000
Businessowners:	
Office Building	75,600
Business Personal Property	60,000
Computer Coverage	15,000
Business Income	12 months Actual Loss Sustained
Business Auto:	
Combined Single Limits	500,000
Workers Compensation:	
Bodily Injury by Accident	500,000 each accident
Bodily Injury by Disease	500,000 policy limit
Bodily Injury by Disease	500,000 each employee
Commercial Umbrella Policy	1,000,000

Underwriting

The company utilizes two written underwriting manuals. One guide covers all insurance programs underwritten by the company, with the exception of the liability program. The company utilizes a manual prepared by Wisconsin Reinsurance Corporation, its reinsurer, to evaluate liability risks.

The company has a formal inspection procedure for both new and renewal business. A sampling of new applications and of renewal business is inspected by committee members independent of the risk under consideration and review.

Loss Ratio Analysis

The examiners reviewed the last 6 years of loss ratios by agent, used for calculation of bonus commissions, and identified one large agent whose loss ratio over those 6 years was 108%, whereas the company average for the other 32 agencies was 48%. The company did not show any actions taken in response to the high loss ratio. It is recommended that the company review each agent's loss ratio on an annual basis and have written procedures on how to deal with agents that continually have a poor loss ratio.

Claims Adjusting

The company has a claims adjusting committee consisting of three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2001.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. The company has three computers with access being limited to three employees. Software applications used are WRC Systems and Windows 98. The company keeps a manual documenting the WRC Systems; however, if there is a problem, they call WRC systems for help. The company's auditor set up the Windows 98 system and provides any support needed by the employees. Company personnel back up the computers daily and the backed-up data is kept off-site.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed a disaster recovery plan. This disaster recovery plan was reviewed and appears to be adequate.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

- (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
- (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is not in compliance with these requirements. The company has two bonds, with a total face value of \$55,000, held with a brokerage firm. These bonds should be held in the company's custodial accounts. It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards to custody and control of its invested assets.

Investment Rule Compliance

The investment rule for town mutuals allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1. Liabilities plus \$300,000	\$1,274,802
2. Liabilities plus 33% of gross premiums written	1,372,853
3. Liabilities plus 50% of net premiums written	1,339,169
4. Amount required (greater of 1, 2, or 3)	1,372,853
5. Amount of Type 1 investments as of 12/31/2001	<u>1,337,461</u>
6. Excess or (deficiency)	<u>\$ (35,392)</u>

The company does not have sufficient Type 1 investments. Since the company has not invested in any Type 2 investments while being Type 1 deficient, the company is in compliance with the investment rule for town mutuals.

Cash and Invested Cash**\$706,996**

The above asset is comprised of the following types of cash items:

Cash deposited in banks-checking accounts	\$ 5,213
Cash deposited in banks at interest	<u>701,783</u>
Total	<u>\$706,996</u>

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained at a federally-chartered bank in Jackson, Wisconsin. Verification of the checking account balance was made by obtaining confirmation directly from the depository and reconciling the amount shown thereon to company records.

Cash deposited in banks represents the aggregate of twenty-one deposits in nine depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2001 totaled \$34,097 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 1.0% to 6.875%. Accrued interest on cash deposits totaled \$8,602 at year-end.

During the review of outstanding checks, it was noted that some outstanding checks were almost three years old. The company stated that it had no procedures in place for escheatable funds.. It is recommended that the company have a procedure in place for handling escheatable funds, in compliance with ch. 177, Wis. Stat.

Book Value of Bonds**\$640,162**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2001. Bonds owned by the company are held with either a broker or its custodial account.

Bonds were physically inspected by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards to investments made by town mutual insurers, except for the custody issue noted in the Invested Assets section of this report.

Interest received during 2001 on bonds amounted to \$39,532 and was traced to cash receipts records. Accrued interest of \$6,723 at December 31, 2001, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments

\$622,469

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2001. Stocks owned by the company are located in a safe deposit box.

Stock certificates were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards to investments made by town mutual insurers.

Dividends received during 2001 on stocks and mutual funds amounted to \$8,292 and were traced to cash receipts records. There were \$129 in accrued dividends at December 31, 2001.

Book Value of Real Estate

\$7,885

The above amount represents the company's investment in real estate as of December 31, 2001. The company's real estate holdings consisted of land and building with book values of \$6,692 and \$1,193, respectively.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards to investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Premiums and Agents' Balances in Course of Collection **\$8,527**

The above ledger asset represents the amounts due from agents or which are not in excess of 90 days past due at year-end. A review of individual agent's accounts verified the accuracy of this asset.

Premiums, Agents' Balances, and Installments Booked But Deferred and Not Yet Due **\$144,630**

The above ledger asset represents premiums and agents' balances which are receivable, but not yet due because the insureds have chosen a semiannual or quarterly billing mode.

This asset was documented by an automated report, itemizing the company's calculation of installments booked but deferred and not yet due for each policy in force as of December 31, 2001. The examiners' review of the entries on this automated report, which included recalculation of the company's results for policies selected on a sample basis, and review of the subsequent collection of the balance, verified the accuracy of this asset.

Investment Income Due and Accrued **\$15,454**

Interest due and accrued on the various assets of the company at December 31, 2001, consists of the following:

Interest accrued on cash deposits	\$ 8,602
Interest accrued on bonds	6,723
Dividends accrued on stocks	<u>129</u>
Total	<u>\$15,454</u>

Reinsurance Recoverable **\$180,000**

The above asset represents recoveries due to the company from reinsurance on losses which were paid on or prior to December 31, 2001. A review of year-end accountings with the reinsurer and review of subsequent collection of the balance verified the above asset.

EDP Equipment**\$6,282**

This asset consists of computer equipment. The amount reported is net of accumulated depreciation and excludes software. The examiners verified this asset amount by physical inspection and by reviewing the method of depreciation.

Prepaid Expenses**\$0**

This asset consists of prepaid 2002 membership dues to the National Association of Mutual Insurance Companies and insurance premiums paid in advance on various corporate coverages. The listing of prepaid expenses was footed and traced to the general ledger. The 2001 annual statement correctly reflects this \$9,054 asset as nonadmitted.

Furniture and Fixtures**\$0**

This asset consists of \$3,403 of office furniture and equipment owned by the company at December 31, 2001. The company is using the five-year straight-line method, with a half-year convention, to depreciate this asset. It is properly recorded as a nonadmitted asset.

LIABILITIES AND SURPLUS

Net Unpaid Losses

\$234,790

This liability represents losses incurred on or prior to December 31, 2001, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. Differences are reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus."

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	\$ 460,792	\$463,236	\$ (2,444)
Less:			
Reinsurance Recoverable on Unpaid Losses	<u>(226,002)</u>	<u>(357,774)</u>	<u>(131,772)</u>
Net Unpaid Losses	<u>\$ 234,790</u>	<u>\$105,462</u>	<u>\$129,327</u>

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2001. To the actual paid loss figures was added an estimated amount for those 2001 and prior losses remaining unpaid at the examination date, if any. The majority of the difference relates to the fact that the company did not take into effect the amount of reinsurance applicable to one outstanding claim at year-end.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

Unpaid Loss Adjustment Expenses**\$585**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2001, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is multiplying the number of open losses at year-end times the amount that directors receive for adjusting losses, which is \$45. The company's methodology is not appropriate since it does not take into account the magnitude of open losses at year-end; for 2001 about half of the company's losses were open at year-end. The examiner used a paid LAE to paid loss methodology to determine the appropriate accrual of unpaid loss adjustment expenses at year-end. The paid to paid methodology noted a significant difference from the company's estimate. It is, however, suggested that the company use a paid LAE to paid loss methodology to determine the appropriate accrual of unpaid loss adjustment expense at year-end.

Commissions Payable**\$62,261**

This liability represents contingent commissions payable to agents as of December 31, 2001, together with an estimate of commissions that will be paid on premiums, agents' balances, and installments booked but deferred and not yet due. The \$32,759 related to contingent commissions was verified by recalculating the amounts payable in accordance with the written contingency commission contract and by tracing to subsequent payments. The \$29,502 that constituted an estimate of future commission payments was deemed reasonable by using the average commission rate for the year and multiplying it by the deferred premium balance. j

Fire Department Dues Payable**\$541**

This liability represents the fire department dues payable at December 31, 2001. The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

Unearned Premiums**\$579,740**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using the daily pro rata method, with applicable adjustments for policy changes and reinsurance activity.

During the review of unearned premiums, it was noted that the company had included \$22,891 in unearned premiums that were actually advance premiums. Per the annual statement instructions, premiums received in advance should be reported separately on page 3, line 12F of the annual statement. It is recommended that the company record advance premiums separately on the liability page of the annual statement, per the annual statement instructions.

Reinsurance Payable**\$88,695**

This liability consists of amounts due to the company's reinsurer at December 31, 2001, relating to transactions, which occurred on, or prior to that date.

Class A-Excess of Loss	\$32,762
Class B-First Surplus	14,733
Class C-1-Excess of Loss First Layer	19,900
Class C-2-Excess of Loss Second Layer	2,850
Class C-3-Excess of Loss Third Layer	1,500
Class D/E-Stop Loss	16,950

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

Payroll Taxes Payable**\$42**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2001, which had not yet been paid. This item was traced to supporting documentation provided by the company's public accountant.

Accounts Payable**\$8,148**

The reported balance of consists of a liability for miscellaneous expense items. Miscellaneous expense items payable as of a December 31, 2001, included such items as payroll, retirement plan contributions, building maintenance, utilities, telephone, office supplies, equipment

maintenance, and inspections. Actual amounts payable were verified to canceled invoices and payment records. Review of paid invoices through the examination date supported the adequacy of the company.

V. CONCLUSION

This current examination resulted in 4 recommendations. Gross premiums written continue to increase each year, even though policies in force have been declining. This is due to larger coverages on new business as well as existing policyholders increasing coverage. The company seems to be strong financially and moving in a positive direction.

The policyholders' surplus per this examination is \$1,493,082, which represents an increase of \$125,900 from that reported by the company in its annual statement. The difference is due to the amount of reinsurance recoverable from an outstanding claim at year-end.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 16 Conflict of Interest—It is recommended that the company amend its conflict of interest policy to require that directors who are agents for the company must disclose this fact as a potential conflict of interest, and that directors with a potential conflict should not vote on matters related to the potential conflict, pursuant to s. 612.18, Wis. Stat.
2. Page 19 Invested Assets—It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards to custody and control of its invested assets.
3. Page 20 Cash and Invested Cash—It is recommended that the company have a procedure in place for handling escheatable funds, in compliance with ch. 177, Wis. Stat.
4. Page 26 Unearned Premiums—It is recommended that the company record advance premiums separately on the liability page of the annual statement, per the annual statement instructions.
5. Page 27 Loss Ratio—It is recommended that the company review each agent's loss ratio on an annual basis and have written procedures on how to deal with agents that continually have a poor loss ratio.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Name	Title
Jean Suchomel	Financial Insurance Examiner
John Litweiler	Financial Insurance Examiner

Respectfully submitted,

Rick Anderson
Examiner-in-Charge